

TABLE OF EXPERTS

# EFFECTIVE STRATEGIES FOR SMALL BUSINESSES



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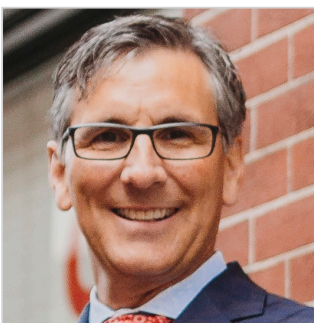


## THE EXPERTS



### MATT MULLEN | SENIOR VICE PRESIDENT/CHIEF LENDING OFFICER, CHESAPEAKE BANK OF MARYLAND

Matt Mullen is the Chief Lending Officer for Chesapeake Bank of Maryland, a community bank located in the Baltimore area. As a commercial lender, he has worked within the community bank arena for 15 years, providing hundreds of millions in financing for real estate projects. Specifically, he has provided financing for owner-occupied and non-owner occupied commercial real estate, multi-family, 1-4 family, land development and hospitality projects. Matt graduated from Salisbury University in 2001 with a B.A in Political Science and graduated from Maryland Banking School in 2016. He is the former President of the Board of Directors for Habitat for Humanity Susquehanna and supports many non-profit organizations in the greater Baltimore area. Matt is married with one son and spends most of personal time coaching his son's baseball and soccer teams.



### BRUCE PALMIERI, CFP® | PARTNER / WEALTH MANAGEMENT ADVISOR, PALMIERI & SHANNAHAN, NORTHWESTERN MUTUAL

Bruce joined Northwestern Mutual as a Financial Advisor in 1990 and has spent his years with the firm gaining valuable experience in the financial industry. He believes not only in continuously educating himself to stay at the cutting edge of the industry, but also in educating his clients to help them make informed decisions for their financial well-being.



### GRAY SHANNAHAN, CFP® | PARTNER / WEALTH MANAGEMENT ADVISOR, PALMIERI & SHANNAHAN, NORTHWESTERN MUTUAL

One thing that all of Gray's clients have in common is that they have a big vision for their futures and value Gray's sound advice and holistic planning philosophy. Gray joined Northwestern Mutual in 2010 and is a true professional who is committed to developing his knowledge and expertise. His favorite part of his job is seeing the life-changing results that a sound financial plan can provide to his clients.

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## INTRODUCTION

**MATT:** I am Matt Mullen, the Chief Lending Officer at Chesapeake Bank in Maryland. I run the commercial, residential and consumer lending teams at a community bank that is headquartered in Baltimore.

**BRUCE:** I am Bruce Palmieri, a founding member of Palmieri & Shannahan with Northwestern mutual and a CERTIFIED FINANCIAL PLANNER™ professional.

**GRAY:** I am Gray Shannahan, also a founding member at Palmieri & Shannahan and a CERTIFIED FINANCIAL PLANNER™ professional.

*What is your overall assessment of the state of small businesses in Maryland?*



**MATT:** With interest rates being low, it is a good time to borrow money and to invest into your business. In the fourth quarter, we have seen an increase in interest rates and things slowed down, but since then, the interest rates have stayed flat and it is proving to be a great time to borrow. Many see a worthwhile investment into small businesses, real estate acquisitions and the acquisitions of new businesses.

**BRUCE:** Our clients feel comfortable. There are a lot of folks back to work mostly thanks to small business who were not working before and they are starting to feel financially secure.

*We recently reported that the number of small businesses sold in Greater Baltimore rose in the first quarter, beating the national trend. What is driving this?*

**MATT:** We are a strong area of opportunity. We have seen major companies come into the Greater Baltimore area, like what Under Armor is doing in Port Covington and the Goldman Sachs investments. We are on the east coast, just outside Washington D.C. This is a good area for investment and people are recognizing this.

*What are some of the most important considerations a business owner needs to make before deciding to sell?*

**GRAY:** First I think the owners need to make sure that selling the business makes financial sense for their personal financial plan. Then, it's common that an owner thinks the business is worth more than it really is, because it is worth more to them than the potential buyer. It's also common that business owners will cover personal expenses through the business which does not translate well to the on paper profitability. Sometimes the business will pay for their car, their retirement savings, etc which are all legitimate deductible expenses, but they hurt the bottom line. While that is a great benefit of being a business owner, it is going to hurt the on-paper profitability of the business and therefore hurts the value when contemplating a sale. We recommend cleaning up the personal expenses for a few years leading up to a sale opportunity to make the bottom line as attractive as possible.

**MATT:** From the lending perspective, when someone is looking to purchase

your business the lender's priority is substantiating the ability to repay. When we look at the tax returns and there are additional expenses, it can diminish the value of the business on-paper. It makes it hard for a lender to differentiate between business expense and personal expense. Often times, we see people trying to reduce their tax obligation, but this shows a weaker company than it really is.

*How are you helping them plan their finances when they were used to a certain lifestyle?*

**BRUCE:** First, we learn about their desired lifestyle. We want to know their personal budget and the business expenses. Sometimes we plan two to three years in advance for an exit.

*Research shows that about 75% of companies do not have a succession plan. Why are companies reluctant to have a succession plan? When should succession planning begin?*

**GRAY:** Succession planning is difficult to plan for because you need to find the right partner to plan with. This is a process that Bruce and I personally did just recently. We completed a succession plan over the past two years. Succession planning takes several years to materialize. The customers of the business expect sustainability in their service and relationships. The

more structure you can have around the sustainability of your business, the stronger the value of the business.

This is especially important to discuss when we are working with family owned business. Harvard Business Review has reported that only 30% of family owned business pass successfully to a second generation, and only 10% pass successfully to a third generation!

*When you are meeting with companies is succession planning something you discuss or is it something you expect is happening within an organization?*



**MATT:** We rarely see companies who have formal succession plans in place. We try to help them create a plan or understand what their plan is. We ask them the tough questions. What happens if something happens to you? As a lender we look at ourselves as a partner because we could be with you for five years or up to thirty years. Small business owners do not always look ten years out, so this is where we jump in and help that process.

*You mentioned that finding*

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**a partner to involve in the succession planning can be difficult, how do you go about finding the right partner?**

**BRUCE:** It will most likely happen with a relationship that already exists. Sometimes businesses sell to competitors and other times they sell internally to a key employee. The people you already know are usually the best partners or the best successor. And as Gray mentioned, the successor could be a family member. It is easy to take for granted that a family member understands the plan and the future of the company, but it is equally as important to do your due diligence in this situation given the failure rate of successful transitions in family owned businesses.

**What are the key insurance and financial planning considerations for small businesses to protect the owner or partners and what is the order of priority?**



**BRUCE:** We feel that protecting what we have started to build is the most important thing. When you are looking at insurance as a solution to protecting, start with the most probable, which is typically health insurance. Second is disability insurance. The third is key person protection. If somebody were to pass away, how do we replace the individual?

**GRAY:** Health and welfare benefits like group life, disability, and retirement plans are important to retain talent and provide a good quality of life for all of your employees, but they do not protect the business. Key person life insurance and disability insurance are critically important to make sure the business can sustain the loss or absence of a most valuable player. If you have one sales person that drives 30% of the revenue of your company, what are you going to do if that person is not able to work for a year or if they pass away? It is important to make sure those client relationships transfer and that you can replace the position. Some of these things you cannot insure, but by placing policies of life insurance or a key person disability which have a lump sum payout can help the business and bridge the gap of transition.

**BRUCE:** Having a relationship with a small bank is very important to a small business. We encourage our clients to have a strong banking relationship.

**What is the state of lending right now? Interest rates are low, but I**



GETTY IMAGES

**still hear from small businesses that obtaining capital can be a challenge?**

**MATT:** Making sure you surround yourself with good people and having a plan is key. When opening or buying a business, you need to think about what you are trying to do. I always encourage someone to know exactly what they need to borrow.



**“A strategic plan is critical to success. One of the things I often see with unsuccessful businesses is they create a business plan, bind it and make it look very nice and professional and then put it in a drawer and go back to their daily grind. So often the business plan does not get executed. To keep our focus on our goals and vision, we hold weekly accountability meetings to review where we stand and where we are trying to go and then quarterly review meetings to see if we are making progress or if we need to pivot.”**

— GRAY SHANNAHAN

Educating yourself before going to the bank or a lender is very important. It is important to note that community banks such as Chesapeake Bank of MD, provide more than 60% of all small business loans.

**What if you are looking to start a business? What financial considerations need to be made?**

**MATT:** The first thing I talk to people about is using all your resources. There are small business development centers, find a mentor and learn about the ups and downs of owning a business. Making sure you have a good accountant, financial planner and banker on your team. These are your board of advisors. Opening a business is challenging and this will help navigate the waters.

**BRUCE:** Our first discussion is the fact that the individual needs to have a leap of faith and trust in themselves that they will do whatever it takes to be successful. After this, we start with the financial planning. The first step is internal, it is a mindset to be successful.

**GRAY:** In order to survive as a new business, you need to really believe in yourself. You also need to have sources of funds available to get started. First, decide which sources of funds are available: such as, personal sources like self-financing, savings, credit and obtaining financing from friends and family. Being able to show a concise a thorough financial plan is essential for anyone looking to approach friends and family. There are some basic elements that every plan should

include.

Also consider outside sources, like investors such as bankers, VC and angel investors. For this, a more formal business plan is appropriate. Being able to show a concise a thorough financial plan is essential for anyone looking to approach friends and family. There are some basic elements that every plan should include. Lack of substantial funding is often the number one barrier to starting or growing a business. The 2 types of financing options are debt financing and equity financing. There are pros and cons to each. For example, debt financing includes paying interest, but owners retain full ownership, while equity financing reduces ownership, but can improve a company's worth. It is a lot to sort through and you really need good financial partners to help you.

**What does it look like when someone comes to you and wants to start a business by first looking at their risks?**

**GRAY:** We come across a lot of people that are starting a business, but more often we are coming across people that are two or three years into starting a business. They have already made a mark in their industry and need to figure out what to do with the money they are making.

**BRUCE:** As planners, we work with clients to help them create the vision, mission and goals for themselves. We start by asking them to clarify their “why” It is the goal setting meeting we call discovery that helps us learn how our clients think and how they

make decisions. We then help them explore all that they may need when starting a business which includes banking, insurance and investments.

**When is it time for a small business to consider expansion?**



**BRUCE:** Expanding a business is all about getting out of the way. A lot of small business owners do everything themselves. They are the face of their business enterprise. We help them think about who is the next person that can replicate what you have done, build on it, and create more capacity for you and your company.

**There are risks to expanding a business, but there are also risks in not expanding, especially when there is competition. When do you know the difference?**

**MATT:** We sit down with clients to make sure they have a financial understanding of their business. A lot of small business owners will use quick books to produce their tax return, but do they understand what those numbers mean.

Business owners will often measure the health of their company by their top line sales, instead of the whole picture. It is a big step to understand the business financial picture, then business owners can understand how much room they have to grow and what are the next steps.

Do they need to get a second location? Should they take on a line of credit that will bridge the gap? How much cash do they have in the bank? Knowing if they can expand and what it will take to get there.

**BRUCE:** Organic growth can be a really good and healthy thing for an organization. Sometimes the challenges come when companies try to grow too quickly and take on unnecessary debt. Taking on debt to grow is not necessarily a bad thing but without a strategic plan, it can add unnecessary risks.

**MATT:** Often companies are unsuccessful in the short term because they expand, but they have not built the foundation they need. They do not understand the idea of taking on a partner or a succession plan. Suddenly, they went from a small amount of revenue to a much larger number. It is best to plan in five-year increments thinking about where they want to be and what they need to do to get there.

We are a small business and Chesapeake Bank practices this all the

time. We want to grow to a certain size and have profitability, so what do we need to do to get there? We are always thinking one to five years ahead.

**As a small business that wants to position themselves for growth, in what areas of the company should a small business be investing in to put themselves in the best position to grow?**

**BRUCE:** Most of the small businesses we encounter need to bring in more sales people. In a small business, it is about the revenue that is generated to help them grow. We cannot cut expenses and call that growth. If their business is going to grow, we help them focus on top line revenue growth.

**MATT:** Small business' must also invest in their financial knowledge, making sure they understand what all the numbers mean. Understanding what the receivables turn is, how much inventory there is and how much inventory may be taken on.

Additionally, understanding the culture of your company. Do the employees believe in what the leaders are trying to do? This is valuable, especially as the business expands when you must rely on your team more and more.

**BRUCE:** I agree – you need to build the team, build infrastructure, build the vision and help to build the culture, because the team will build the culture.

**Another challenge small businesses have is recruitment. Is there a way to optimize with the current employees? Or is the answer always to bring in more sales people?**

**GRAY:** Recruiting can be a challenge and so is retaining good employees, especially in a tight job market. Finding the right person, especially in small business which usually means they cover multiple job duties is not easy. This is why it often times makes sense for small business to really invest in the development of their team and provide the vision of career growth to the people who are already on board. Developing a culture that your small business is the place to be starts with bringing the right people on board and then taking care of them. It's not just about taking care of them financially, but rather showing them that you really care for them and that you understand their goals.

**This ties in with strategy. How important is it for a small company to have a strategic plan?**

**BRUCE:** We look at strategic plans as a road map. It is the map of the business, what we are trying to accomplish and the timeline the goals should be



*" We look at strategic plans as a road map. It is the map of the business, what we are trying to accomplish and the timeline the goals should be achieved. The strategic plan will list anything that matters to the future projection of the business. Goals like revenue, profitability and number of employees by a certain date. It is not uncommon that this plan will change five or six times in the first year"*  
– BRUCE PALMIERI

achieved. The strategic plan will list anything that matters to the future projection of the business. Goals like revenue, profitability and number of employees by a certain date. It is not uncommon that this plan will change five or six times in the first year.

**GRAY:** A strategic plan is critical to success. One of the things I often see with unsuccessful businesses is they create a business plan, bind it and make it look very nice and professional and then put it in a drawer and go back to their daily grind. So often the business plan does not get executed. To keep our focus on our goals and vision, we hold weekly accountability meetings to review where we stand and where we are trying to go and then quarterly review meetings to see if we are making progress or if we need to pivot.

**This is good advice because one of my favorite words is pivot. I find that a lot of companies are reluctant to change direction and instead hold onto the original plan.**



**MATT:** What we are finding today is different than what business was like ten years ago. Things change quickly now. In the banking business, the velocity of money and technology is greater and greater. As a small business owner, you must have the ability to reassess and establish what you think you are going to do.

Business owners get into the daily grind, but a lot of times they do not have the time for reflection. It is important for small business owners to take two minutes to evaluate if they are where they want to be. Whether it is writing it down on a formal strategic plan or writing it on a white board, reflecting and asking themselves, "Am I getting there?"

**BRUCE:** This should also include the marketing plan. The marketing plan is just as important as the profitability plan.

**We recently read that Chesapeake Bank raised additional capital by converting to a stock bank. What is the value of working with a smaller business bank?**

**MATT:** Where community and smaller banks have a leg up is that we are a small business too. We have 45 employees. Just because we have "bank" on our name does not make us somebody that does not understand what you go through on a daily basis.

We get it. When you are repricing your healthcare in October and realizing that the cost is going up, we are doing the same thing. By working with a smaller bank, you will be able to get to decision makers quickly. It is less about being an account number and more about being a real person. A recent study completed by the Federal Reserve found that 79% of independent businesses that used community banks report there were satisfied with their overall experience, compared to 67% for large banks and 49% for online lenders. We work hard to partner with the business and not just give them a loan.

**GRAY:** We are in a relationship focused business and there is nothing more intimate than people's finances and their financial goals. Our clients know us well as their advisors and also know our team members that serve their accounts. There's a level of trust and intimacy that can be earned in a small business that a larger firm may not be able to replicate due to their scale.

**BRUCE:** It seems that most of our work is reviewing the plan and modifying as we go. We deliver plans, almost every year for our clients. We show them the forecast, projection and Monte Carlo analysis that shows them a stress test of their portfolio based on historical returns.

**What other service should small businesses be utilizing or seeking out?**

**MATT:** There are your traditional banking products of your loans and deposits, but banks also offer merchant services, such as credit card processing. We can partner with point of sale service companies to make



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sure they can get their credit cards to wherever their point of sale terminals are in a particular location.

Your banker and your bank can handle all these different things for you. There are a lot of products that banks have to offer, including online banking. We want to make it convenient for you.

Other resources include talking to people at small business development centers. You can find business counselors that help you understand what you are trying to accomplish, how you are going to grow your business and how to set up a strategic plan.

**As a business owner, should I be doing my personal financial planning separate from or as a part of my business financial planning?**



**BRUCE:** Owners of business’ do plan simultaneously for the personal and their business. The common question is, can my business pay for a personal expense. We encourage them to seek the council of a CPA, so that they can get the proper tax advice as they make these decisions.

We do encourage them to separate the two. It is important to have business objectives and finances and personal

objective and finances. When you bring them together and there is no delineation, it makes it very difficult for to sell a business later and to provide appropriate documentation to a bank if you need capital.

The discussion about financial planning for an owner of a small business often is completed together. The business can pay for retirement planning, key person planning, some insurance policies and health insurance. On the personal side they need some personal savings and investment plans, as well as personal insurance and that should be funded out of their net paycheck rather than out of their business.

**Your client relationships consist of helping both with their personal lives, as well as their business?**

**BRUCE:** Almost exclusively, yes.

**Is this the same client relationship for banking?**

**MATT:** A lot of business owners will look to do their personal banking at another bank than their commercial banking. While working with small businesses, we take a look at the whole picture. We consider what the business and the individual is doing.

**GRAY:** When we provide advice to a business owner, we really need to know about the business to be able to provide accurate advice. There are complicated rules about retirement plans and there are different risks that business owners are exposed to.

**MATT:** It is not uncommon to see small business owners plan that their main source of retirement is the sale of their business. This can be tricky. As we invest, we diversify our portfolios. It is important that small business owners think about their long-term plans and how to diversify.

**GRAY:** Owning a business can be very emotional. The emotions often make people think that their business is worth more than it really is, as they are really proud of what they have built. This can cause owners to not have realistic expectations of what their business is going to provide in the long term and lack the proper planning to achieve their financial goals. Sometimes owners need a nudge to be convinced that this is not their only ticket and they need to explore their options. The tax incentives inside of retirement plans can provide an edge and the plans can be very flexible to meet their needs.

**Is this the best time to look at retirement plans?**

**BRUCE:** We end up seeing a lot of

businesses when the economic cycle is at a peak. We are nearing the end of this current economic cycle and we do not know when that will end. If they are doing well, we encourage them to take some money out of the business and diversify it into other areas that can protect them at the end of the economic cycle.

**GRAY:** Economic stages of the economic cycle are like seasons. This is the season to save. It is also important to work with a banker to make sure your line of credits are renewed. When things tighten up, that is usually when everybody wants something, but they cannot always get it. You need to be thinking two steps ahead of the game to be successful.

**Where do you see small businesses in three to five years?**



**MATT:** What we are going to find is the old data that we always used for so long may not apply anymore. We are going to look at things differently. We are going to find that the market is going to stay strong for a while, as long interest rates stay where they are.

It is cheap money, so you have a lot of buying power. As interest rates may increase, you could see things slowing down. If we look back to pre-recession, the interest rates were high at that point. If interest rates stay somewhat low, you are going to have people investing, buying properties and expanding businesses. Looking out five years is a little harder to tell, but the horizon looks positive right now.

**We might start to see a downturn, perhaps as soon as 2020. What advice do you give considering how soon 2020 is, is this the time to start ramping up? How much should I put in my 401k if I’m within three years to retirement or is that just too soon for me to worry about?**

**BRUCE:** We hope you are already at the maximum level of contribution into the 401k plan. What we advise our clients who are close to retirement is to make sure they understand their budget; discretionary income needs and how to protect the income into the future. They can do this by having some money in safe assets, things that will not go down when the market does.

We encourage our clients to seek out a personal line of credit at the time they are getting closer to retirement.

We have learned through statistics that if the market goes down and we can avoid pulling money out of equities during that time until it recovers, we can expand the time that we hold onto those assets throughout our lifetime. We do need something to live on during the downturns. For a 2008 crisis, we recommend two years of income needs in the bank or safe assets, minus your guaranteed income source, such as social security.

**MATT:** We will experience some downturn and you must plan for it. You need a plan B and C. Do you have the capital to get you to where you need to go if things slow down?

Companies must make sure they understand what their plan is. What are their reserves and lines of credit? It is likely that all businesses will face some type of hardship so it is best to be as prepared as possible.

**GRAY:** Just because the economic season may be changing, does not mean the plan needs to change. A well thought out financial plan should sustain all seasons of the economy. The idea of having an emergency fund is common knowledge, but a lot of people do not do it because they do not like sitting on cash. It takes discipline to do that. The value a financial advisor brings to the table is holding people to the discipline to things they know they need to do.

**Any insights you want to offer that we did not cover?**

**GRAY:** The economic climate for business in Maryland is better than I have ever remembered, granted I’m only 32 years old. There are many incubators, such as City Garage and Spark. There are multiple unique places where people can start a business with relatively low costs. There are also technology resources for small business, like Square and different payment processing systems. The climate for small businesses is extremely bright and there is a lot of opportunity to get started.

**BRUCE:** To me, Baltimore seems unique. As you said earlier, businesses have sold in Baltimore at a record number above the national average. There are not as many larger corporations here. I believe that a lot of the service companies in Baltimore and most are small companies.

**MATT:** The smaller businesses too, can be nimbler. They can pivot, more so than the larger companies. There is a political focus on small businesses and business owners. We want to do more business in Maryland and it seems to filter down for sure.